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CORPORATE BEHAVIOUR IN RESTRAINT OF TRADE IN GOODS AND SERVICES IN SRI LANKA

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CORPORATE BEHAVIOUR IN RESTRAINT OF TRADE GOODS AND SERVICES IN SRI LANKA

Sri Lanka - basic data

Geographical situation:	20 miles east of the southern-most extremity of peninsular India
Area:	25,332 square miles
Population:	16.8 million (1989)
National income:	GNP at current factor cost 222,467 million rupees (1989)
	GNP per capita - 13,237 rupees (1989), US$ 367.00
Exchange rate:	Average in 1989 US$ 1 = 36.05 rupees SDR 1 = 46.19 rupees
Trade:	Imports - rupees 80,225 million (1989) Exports - rupees 56,175 million (1989)

COMPETITION AND THE CORPORATE SECTOR

A contrast in attitudes towards competition should be mentioned at the outset. The average educated Sri Lankan does not have much faith in competition as a panacea for the ills of the economy. The same may hold true in most developing countries in South Asia. However, this view is not prevalent in the developed countries. According to The Economist of 13 July 1990, the watchword in the trade war between the United States of America and Japan is "competitiveness". In the past few years a new (and appropriately competitive) industry has grown up around this concept. "Councils, think tanks, business schools, professions, politicians, all stand ready with quotes, pamphlets, books and conferences offering their patent remedies on how to improve their nation's competitiveness". Likewise the Government of the United Kingdom has outlined its policy on competition as follows:

> "Competition is an essential element in the workings of marketing. It encourages enterprise, product and choice. In doing so, it enables consumers to buy the goods they want at the best possible prices. By encouraging efficiency in industry, competition in the domestic market also contributes to our international competitiveness."1/

Until the late 1930s, Sri Lanka (then Ceylon) enjoyed an economy mainly based on colonial plantations with only 11 foreign and 19 locally registered companies (in 1931) engaged in export/import trade, industries and local distribution. They were able to cater to the needs of the population of 5,306,871 (in 1931). With the expansion of population and more people venturing into other areas of economic development, particularly in the mineral sector, the number of companies listed with the Registrar of Companies had risen to 956 (178 foreign companies and 778 local companies) at the end of 1947. The increase in the number of registered companies grew faster than the increase in population, which stood at 6,657,339 at the end of 1947. After

Independence in 1948, Sri Lanka experienced rapid economic growth with an increase in population which stood at 16.8 million at the end of 1989. The registered companies had risen to 17,721, showing rapid growth in the availability of savings ready for investment.

Most of the companies in business today are privately owned - numbering 15,349 - while public companies accounted for only 1,427, of which only 177 companies are registered with the Colombo Stock Exchange. With financial facilities made available to the public through various sources, according to the Registrar of Companies, there has been a substantial increase in the number of companies registered during the past few years.

Two ordinances of the Parliament of Sri Lanka passed in 1987 have had a considerable impact on corporate behaviour. The first is the Fair Trading Commission (FTC) Act No.1 of 1987 and the second is the Securities Council (SC) Act No.36 of 1987. The FTC succeeded the National Prices Commission. While the Prices Commission was only concerned with surveillance of prices of "prescribed" articles, the FTC, while continuing the Prices Commission's price surveillance function, has also been concerned with promoting competition between providers of goods and services.

The primary objective of the SC Act is to encourage the market in which securities are traded in an orderly, efficient and fair manner, while protecting the interests of the investor. Its secondary objective is to develop a securities market, in particular, and a capital market, in general, by widening share trading, encouraging listed companies to seek more capital from the market to finance growth and new investment, promote more companies to seek listing and divert more savings of the public and fixed deposits to shares by promoting establishment of unit trusts, venture capital companies and merchant banks.

The institutions set up by these two ordinances both promote competition - the FTC directly and the SC indirectly. The FTC is there to prevent monopolistic behaviour by a dominant firm as well as mergers which are contrary to the public interest and other forms of anti-competitive behaviour. The SC prevents anti-competitive practices by a listed company such as insider-dealing and manipulative practices.

THE COMPANIES ACT

The Companies Act No.17 of 1982 sets out the procedure for the establishment of a company of any nature. The activities of the company are limited to those given in the Memorandum and Articles of Association where the owners of the company are required to specify in detail the activities of the company and the limitation to such activities. These limitations as given in the Articles and Memorandum, can be changed to suit the owners in keeping with the changing economic pattern, upon proper notification to the Registrar of Companies. This applies to foreign investors and to those who seek registration of liaison offices in Sri Lanka. At present, registration of liaison offices is permitted only to facilitate Sri Lanka exports, manage development projects, [illegible], but not for the promotion of foreign investors' own exports in Sri Lanka.

MONOPOLY AND MERGER OF COMPANIES

Section 15 read with section 11 of the Fair Trading Commission Act No.1 of 1987 makes it permissible for a trader to engage in anti-competitive practices and also allows monopoly situations and mergers if they are not likely to operate against the public interest.

According to Section 11, "The Commission may, either of its own motion or on a complaint made to it by any person, or in the case of a proposed merger on a request made to it by any person, carry out an investigation with respect to:

(a) the existence or possible existence of a monopoly situation;
(b) the creation or possible creation of a merger situation;
(c) the prevalence of any anti-competitive practice."

Under Section 15, " (i) Upon the conclusion of an investigation carried out in respect of any or all of the matters specified in section 11, if the Commission is of the opinion:

"(a) that any monopoly or merger situation or anti-competitive practice exists but such monopoly or merger situation or anti-competitive practice does not operate or is not likely to operate against the public interest, or in the case of a proposed merger that such proposed merger is not likely to operate against the public interest the Commission may, by order, authorise such monopoly or merger situation or anti-competitive practice or the proposed merger ...".

Section 23 of the Consumer Protection (CP) Act No.1 of 1979 also makes it permissible for a trader to engage in anti-competitive practices if the FTC "considers it expedient in the interest of the national economy ...". There are companies which have taken advantage of these provisions in the law.

The provision in the CP Act just quoted and the provision of the FT Act, when read together, could allow a company to engage in certain anti-competitive practices and also allow merger of companies. One is led to believe that the authorities concerned would have taken into consideration the size of the local market and availability of raw materials within the reach of such companies.

On the other hand, Section 208 of the Companies Act No.17 of 1982 makes it very clear that amalgamation of any two or more companies is possible after referring such arrangement to the Court and with its approval. There is, however, nothing to prevent a company acquiring, or shareholders of a company acquiring, controlling shares of another company. This may be another reason why some public companies are still reluctant to float their shares on the Stock Exchange.

Section 55 of the Companies Act prohibits a company from giving, whether directly or indirectly or by means of a loan, guarantee, provision of security or otherwise, any financial assistance for the purchase of, or in connection with the purchase of, shares where the company is a subsidiary.

PRIVATIZATION

It has been decided to privatize almost all government-owned business undertakings so that there may not be any government monopoly except where public enterprises have to be managed by the Government in the national interest, such as power and energy. Already the Government has privatized certain entities by issuing shares to the public of a number of business organizations and industries where the Government had had the sole monopoly. The private sector is allowed to operate bus services. The whole road transport service will be privatized soon.

FINANCIAL MARKETS

Evidence of interest by foreign investors in the Colombo Stock Market (CSM) is indicated by the upsurge in share trading - from a monthly turnover of 18.8 million rupees in 1989 to more than 180 million rupees in June 1990. Similarly, share prices have moved up sharply from a monthly average of 181.5 (base 1985) in December 1989 to 357.7 in June 1990 - an increase of more than 100 per cent.

A 100 per cent tax on share purchase by non-residents has been removed, effectively opening the market to foreign investment. However, the removal of the tax is subject to a limit of 40 per cent, if any non-resident's share holding is in an individual company. After 40 per cent, the 100 per cent stock transfer tax still applies. Investors must also be aware that foreign exchange controls are still in place. Transfer of funds for investment purposes into and out of the country must be approved by the Government. The administration has not detailed its intentions on the controls.

There appears to be an anti-competitive practice at the Colombo Stock Exchange. The management has withdrawn intercom facilities from the public gallery in a move, perhaps, to prevent small-time investors from patronizing the Stock Exchange. This facility had been available to small investors to contact their brokers direct and to watch the trend of the share market on the Trading Floor. Most of these small investors have no telephone facilities at their residences by which to contact the brokers and thereby avoid going to the Trading Floor - particularly in view of the fact that the brokers' offices are now quite far from the Stock Exchange Trading Floor. Moreover, most of these small investors are retired persons who make use of the savings of a lifetime from their provident funds or commuted pensions to invest in quoted companies since they fear to put their savings in finance companies after the recent spate of bankruptcies. It is part of the functions of the Stock Exchange to facilitate the mobilization of the funds of small savers. If the Colombo Stock Exchange is to perform this function adequately, better facilities should be provided for small investors to participate on the Trading Floor.

DIRECT FOREIGN INVESTMENT

Direct foreign investment, which is largely or entirely export-oriented, is promoted by the Greater Colombo Economic Commission which operates in the two Investment Promotion Zones of Katunayake and Biyagama. The main features of the Greater Colombo Economic Commission's tax financial incentive package are as follows:

(i) No restrictions on equity ownership

(a) The project may be 100 per cent foreign-owned. Joint ventures with local companies are also welcome;
(b) Shares can be freely transferred within or outside Sri Lanka;
(c) Dividends can be remitted without tax or exchange control restrictions;
(d) Capital and proceeds of liquidation are repatriable without tax or exchange control restrictions.

(ii) Tax exemption of 100 per cent for up to 15 years

(a) A company can qualify for 100 per cent exemption from corporate income tax for up to 15 years, depending on project characteristics;
(b) After the tax exemption period, concessionary taxation is available for up to 15 years.

(iii) Other tax exemptions

(a) No tax on royalty remittance during the exemption period;
(b) Tax exemption on earnings of expatriate staff for the duration of the tax holiday;
(c) Double taxation relief;
(d) Import of construction materials, plant, equipment and raw materials and export of the final products or semi-finished goods are free of duty.

The contracts of establishment of foreign firms in the Investment Promotion Zones have been examined and no clauses which could later lead to output limitations or restraints on markets for exports have been found.

Although in theory, preference is given to foreign firms which make use of local raw material, a sample survey done in 1981 of 30 Greater Colombo Economic Commission firms (22 in the garment sector and eight in non-garment sectors) showed that the utilization of local inputs in total raw material usage in Free Trade Zone enterprises was only 5 per cent. Garment manufacturing firms, which account for 93 per cent of the total raw material used in the zone enterprises, utilized only 3 per cent of local raw material in 1981. Local resource-based industries, such as cashew products, rubber products, tea packaging, etc. accounted for only 2 per cent of total raw material usage. Although Greater Colombo Economic Commission had firms have shown some improvement in the use of local raw material in the post-1981 period, this was still below 10 per cent. However, production in the Investment Promotion Zones is not derived essentially from imported inputs because of any restrictive clauses in the contracts of establishment.

Foreigners can own 100 per cent share capital of a company in the Free Trade Zones and they are at liberty to sell their shares.

The functions of the Foreign Investment Advisory Committee, which dealt with foreign investments outside the Free Trade Zones, are now amalgamated with the Greater Colombo Economic Commission. Foreign investors would naturally prefer to locate their industries in the same area where raw materials - particularly those which are heavy and expensive to transport - are available. Nevertheless, such investors are given only a maximum of 10 years tax holiday compared to 15 years in the Free Trade Zones. This sort of discrimination against an investor who uses local raw materials seems unfair. The investors in the Free Trade Zones largely import their requirement of raw materials.

CONCESSIONAL FINANCE

Under the present economic policy of the Government, financial assistance on concessional terms from the Medium and Long Term Credit Fund of the Central Bank (MLCF) and Small and Medium Scale Industrial Credit Guarantee Scheme (SMI) of the National Development Bank (NDB) is provided to investors. Likewise, the Development Finance Corporation of Ceylon (DFCC) and commercial banks provide assistance by way of loans and equity participation. The Export Development Board also provides financial assistance to export-oriented projects. The National Development Bank extends financial assistance to industrial projects by way of loans and equity participation. In 1989, the National Development Bank approved 144 such projects with an outlay of 1,084 million rupees for direct financial assistance. Commercial banks have continued to provide financial facilities for industrial purposes; this amounted to 12,536 million rupees in 1989.

Under the New Comprehensive Rural Credit Scheme (NCRCS), credit institutions are continuing to provide short-term cultivation loans at concessionary rates of interest with the support of the Central Bank which gives 100 per cent re-finance and 50 per cent credit guarantees. In addition, the Central Bank also grants financial facilities for medium- and long-term investment covering a wide range of economic activities in the agricultural sector through 28 credit schemes, with a view to alleviating rural poverty. Cooperative banks are also in operation. Financial assistance extended by the Central Bank and other agencies now covers all sectors of the Sri Lankan economy.

However, liquidity pressure on commercial banks has kept the inter-bank call money market rather high throughout the whole of 1990, a situation likely to continue for some time. Nevertheless, the banking facilities extended under the Praja Niyamaka Scheme introduced in October 1988 for the purpose of extending financial facilities to village areas as a forerunner to the promotion of Agency Banking proved to be successful.

JOINT VENTURES

Instead of exporting raw materials, Sri Lankan investors are now looking for foreign collaborators with technical know-how. Some have been extremely successful in this regard. One good example concerns activated carbon derived from coconut shell charcoal. Sri Lanka had been exporting coconut shell charcoal as raw material to Japan and Germany for a long time, but had earned very little foreign exchange. A study made by the Japanese Chemical Association, found that Sri Lanka coconut shell charcoal contains less ash and sand than other sources and that it is ideally suited for production of activated carbon. The Japanese brought their technical know-how and Sri Lanka is now exporting activated carbon in large quantities.

This type of investment by foreigners is made possible because of the new policy measures of the Government. Foreigners can hold 40 per cent shares of any local company outside the Free Trade Zones. They are also permitted to expatriate their profits. Owing to the high cost of production and transport of raw materials, as well as the double handling charges, foreigners prefer to manufacture the final products close to the sources of raw materials. This is especially so in regard to raw materials which are categorized as dirty-cargo by the shipping lines.

INDUSTRIAL POLICY

A new industrial strategy was introduced by the Ministry of Industries and approved by the Cabinet on 27 December 1989. The new strategy seeks to:

(a) Transform import-substituting industry into export-oriented industry;
(b) Provide greater employment and income opportunities;
(c) Diversify the economy and strengthen the balance of payments;
(d) Ensure a more equitable distribution of income and wealth.

The strategy also includes policy measures aimed at: mobilizing resources for investment and exports; encouraging foreign and local investment; reforming public enterprises; promoting a competitive environment; establishing a linkage between large and small industries; promoting research, training and marketing; and removing administrative obstacles to investment, production and exports.

As far as the Fair Trading Commission is concerned, the new industrial policy has resulted in a fairly drastic reduction in the number of "prescribed" articles, from 43 to 26, that is, the Commission's price surveillance function will be confined to only 26 articles, 17 articles having been removed from the list of commodities, the manufacturers of which are obliged to submit for the Commission's consideration any variation in prices.

FINANCE - LACK OF COMPETITIVE AVENUES TO INVESTMENT

A vast number of new finance companies have mushroomed in the past 20 years. Before introduction of the first Finance Companies Act No.27 of 1979, all that an individual had to do before starting business as a finance company operator was to seek registration under the Companies Law. This was cheap and relatively easy. After registration, even if he had no capital to put up, all he had to do thereafter was to insert a large advertisement in the newspapers promising very high rates of interest, with leading captions on security and stability, and deposits would flow in thereafter.

As a result, in the 1970s, a large number of companies were able to start business with relative ease. A most important factor that influenced the growth of finance companies was the lack of relatively attractive alternative investment possibilities in a society where the habit of saving and investment was fast growing. Sri Lankans who had worked in the Middle East found investment in finance companies very attractive.

Commenting on the management of the new finance companies, the Governor of the Central Bank, Dr. Karunatilleke, has stated: 2/

> "As long as deposits came in, the new finance companies were not faced with difficulties in meeting regular commitments to their depositors. For many companies the need for profitable investments was not the main consideration, but a continuing cash flow. To ensure the latter, many companies entered into major advertising campaigns which were beyond their means. As there was the expectation that there would be an uninterrupted flow of funds, a large number of companies did not pay sufficient attention to build up sound assets portfolios with adequate margins to service the commitments to depositors.

"Equally, the avenues for high-yielding investments for depositors' funds were relatively few and many companies who obtained deposits from the public did not find it easy to repay because their investments did not bring in high returns. Several companies fell into difficulties with a reduction in the rate of flow of new deposits, particularly after 1984 and they did not have sound investments with very high yields which could meet their commitments. This position was aggravated in the period 1986-87 when a virtual ceiling on the rate of interest on deposits, which was substantially below the actual rates paid by companies, resulted in a sharp reduction in the flow of funds into finance companies."

To enable finance companies to pay depositors over 30 per cent, the company had to charge the borrower 45 to 50 per cent per annum. Apart from money lending in the unofficial money market, the only area with very high yields has been in passenger vehicle and private motor car finance.

Anti-competitive practices by finance companies are legion. Many finance houses in difficulty had followed the unsatisfactory practice of providing funds to their own subsidiaries. This would at least have had some justification if the companies concerned were making profits and were efficiently managed. On the contrary, the performance of these subsidiaries was dismal and the companies obtaining loans at specially favourable rates of interest were making big losses. Hence there were no returns on the investment.

In early 1989, the Central Bank set up a new department for the supervision of non-bank financial institutions. This department has, with the the concurrence of the Monetary Board of the Central Bank, introduced certain maximum deposit interest rates for finance companies "in order to prevent excessive competition between finance companies". According to Direction 2 of 1989 on Rates of Interest and Other Charges, the maximum annual rate of interest payable on 12 months deposits is 20 per cent per annum, and the maximum interest payable on longer time deposits is 24 per cent. Although on the face of it, this may seem to be an anti-competitive practice, the control seems justifiable in view of the number of depositors, in finance companies who have suffered the loss of a lifetime's savings.

According to Dr. Sirisena, Director of the new department:
"The competition between the finance companies has to be largely on the quality of services they offer to depositors and borrowers. The price competition, particularly in respect of interest rates paid on deposits has to be within a narrow range."3/

AUCTION SYSTEM

The main commodity accounting for nearly 80 per cent of Sri Lanka's total exports prior to 1900 was tea. The major buyers were the British tea giants. Planters, however, felt that they were not getting a correct price and that the international price was not reflected in the offers they received from the buyers. Moreover, they found that they could get a better price if they shipped their tea to the London Auctions which commenced in 1877. In order to get the best price possible and also to enable the buyers to obtain the required quality grades in the quantities they needed, the auction system was introduced in Sri Lanka in 1883 on the same pattern as in London. Yet some planters continued to ship their tea to the London auction on long-term contract bases.

A tea auction is quite different from other commodity auctions. The quality of tea coming from different estates, and very often from the same estate, depends on elevation, windward side or leeward side, soil, availability of rainfall, etc. Therefore, samples are made available to the prospective buyers in advance so that they may know the different quality grades of tea and the quantities of a particular grade offered at the auction. The requirement of buyers depends on the blend they have tested: some may require a large quantity of a particular grade while others may require only a small quantity.

At the auction tea is offered in lots, not in small parcels, and therefore the buyer has to buy the entire lot of a particular quality grade coming from an estate. There may be other buyers who do not require large quantities of that particular quality. They therefore make known to the prospective buyers the quantities they need of a certain grade and thus share the lot among themselves depending on their requirements for a particular blend. This cannot be considered "collusive" bidding. Anyone can bid at the auction. At the auction, as the hammer falls, they have to indicate their individual requirements by raising their hands and registering the quantities they need. They all pay the same price irrespective of the quantity they need. This is a perfect auction system where the need of the smaller buyer is also served satisfactorily. What happens after the purchase at the auction will be dealt with later.

Dessicated coconut was also sold under auction for some time. In order to remove certain forms of malpractice among dealers, this item has now been withdrawn from the auction system, as buyers need large quantities of different cuts: for example, the Mars Cut is required only by Mars Chocolate Company. Copra is still under the auction system. Supervision by the Ceylon Chamber of Commerce ensures that anti-competitive practices such as collusive bidding are avoided.

TECHNOLOGY SUPPLY

Technology is not desired for its own sake. It is desired only if it has the power to produce something which is in demand. The development of technology is both costly and risky. Therefore, unless the economic environment makes it viable to invest in technology development, it is unlikely that resources would be available for such development.

The development of technology in Sri Lanka is risky owing to the limited size of the market, the type of product and the level of competition. No manufacturing activity can depend solely on equipment designed for development in Sri Lanka. It has been observed that: "In the absence of a technology development base, it would be advantageous from an efficient resource-user point of view, to import technology initially for mastery through usage in industry and for redesigning and adaptation - subsequently."[4/]

Investment in research and development by the private sector has been constrained by high risk owing to instability, non-predictability, etc., and public sector research and development institutions have failed to satisfy domestic technological needs. Market forces, however, call for competitive quality and price. Imported technology is costly. This makes for a conscious policy for development of local technology and innovation essential.

Although wide-ranging discussions have been held with the Greater Colombo Economic Commission which licenses foreign investment, there are no known cases of restrictive clauses in licensing agreements with foreign investors who supply technology, taking advantage of their dominant or monopoly position in the market in question.

In Sri Lanka, information on technology has not been readily available in the past to guide investment and operational decisions. Identification of market prospects, investment opportunities, available technical options, sources of technology and their prices, emerging technological innovations, etc., has been constrained by the absence of a technology information base. However, this situation is expected to change with the new White Paper on Industry, "A Strategy for Industrialisation in Sri Lanka". Steps have already been taken to implement para. 9.1. of the White Paper which states:

> "with the promotion of a competitive environment in industry, the demand for technology will increase. The Government will play a catalytic role in the transfer of relevant technology by assisting industries to identify, procure and absorb new technologies which will enhance Sri Lanka's competitive advantage. Acquisition of technology will be promoted by stimulating foreign investment which will be used as a vehicle for the transfer of technology."

INSURANCE

The Government de-regulated the insurance industries a few years ago and permitted the private sector to start insurance companies in competition with the State sector. However, despite assurances given to the private sector that they would be allowed to compete on equal terms, the regulations (which apply only to the private sector) are such that the State sector has the following advantages which make competition by the private sector difficult:

(a) Appointment of institutional agents

The Control of Insurance Act No.25 of 1962 permits insurers to appoint only individuals as agents. Private insurers have to comply with this Act. The State insurers, however, continue to appoint institutions as agents. This enables them effectively to give rebates equivalent to agency commission on the premium, and hence have a special pricing advantage.

(b) Payment of commission

The Insurance Regulations promulgated under the Control of Insurance Act lay down maximum rates of commission and brokerage that the insurers may pay the agent or broker. These limits do not apply to the State insurers, thus enabling them to offer higher rates of commission. This gives them a special advantage.

(c) Compliance with tariffs

The Control of Insurance Act and the Insurance Regulations empower the Controller of Insurance to fix minimum and maximum premium rates. Under the power so vested, the Controller of Insurance has directed private insurers to adhere to market rates of premium and, where applicable, to the relevant tariff rates. There are tariffs for Fire, Motor and Workmen's Compensation Insurance. A similar directive does not seem to exist for the State insurers. In the absence of such a directive, the State insurers obviously have a competitive advantage since they are able to change rates without any restrictions.

(d) Credit

The Control of Insurance Act stipulates that the insurer shall not be liable to pay any amount owing under any policy of insurance unless the full premium due is paid at the time it is due or there is a bank guarantee. The latter is permitted only up to a maximum of 30 days. State insurers are known to provide credit on the basis that neither this Act nor the Regulations apply to them.

(e) Compulsory sessions

Under the Control of Insurance Act, private insurers are obliged to cede to the National Insurance Corporation (NIC) 15 per cent of every fire and marine policy written by them. It appears that the commission paid by the NIC for this business is far below the rates of commission received by private insurers from their professional insurers. Apart from the loss in competition, the position is anomalous because the NIC is also a competitor to the private insurer. Further, the Insurance Corporation of Sri Lanka (a State insurer) does not cede 15 per cent to the NIC.

(f) Powers of Control of Insurance

The Controller of Insurance has been vested with power to ensure that the private insurers transact insurance business in conformity with the Control of Insurance Act and related Regulations. The Controller of Insurance does not appear to have similar authority over the two State insurers.

(g) Monopoly of Government/corporation business

Government business and that of public corporations have to be written by either of the two State insurers. Private insurers are precluded from participation in this business.

EXPORT FINANCE AND GUARANTEE

The Sri Lanka Export Credit Insurance Corporation (SLECIC) was set up by Act No.15 of 1978. Before the Corporation was set up, new and small-scale exporters were obliged to obtain credit from commercial banks. Banks were often reluctant to make available finance to exporters who did not match their standard of credit rating. If the buyer did not pay the dues or was insolvent, the exporter suffered the full loss. Often banks had to suffer the full loss for financing the exporter at pre- and post-shipment stages.

The Corporation commenced operations in February 1979. It operates on a "no loss, no profit basis". SLECIC underwrites export credit risks and also risks arising from non-payment or delayed payment. SLECIC is a member of the International Union of Credit and Investment Insurance called the Berne Union. The Berne Union comprises 40 export credit insurers, both public and private institutions. There are certain basic principles universally accepted by these export credit insurers:

(a) Co-insurance which indicates that 100 per cent cover should not be accepted. The individual or firm insuring should also bear a certain percentage of the loss.

(b) The loss is indemnified to the insured if the terms of the contract are fulfilled. Therefore, recoveries should follow.

(c) Export credit insurance is a means of protection for exporters.

The credit insurer underwrites insurable risks and takes on calculated risks. He does not take on blind risks. As SLECIC is a public institution, risks have to be carefully minimized and only risks beyond the control of the exporter and the buyer are paid out as claims by SLECIC.

The Berne Union fixes the minimum interest rates that their members can levy. In other words, as far as interest rates are concerned, there can be no competition between the various export credit guarantee organizations which are members of the Berne Union. It is worth investgating whether the Berne Union is guilty of restrictive business practices in that it does not permit competition between its member organizations as far as interest rates are concerned.

THE LEASING INDUSTRY

The development finance institutions (DFI), which are either public sector or para-statal in character, have extended into direct competition with private companies engaged in leasing, with the following competitive advantages:

(a) They enjoy concessionary funding from the World Bank and other such lending institutions;
(b) They bear no exchange risk on their borrowing from such sources, as the risk is borne by the Central Bank;
(c) They do not have to pay turnover tax on their leasing income. There seems to be an anomaly in the tax treatment of leasing companies, development finance institutions and commercial banks with regard to the levy of turnover tax.

Leasing companies have to pay 3 per cent on their total lease rental, which includes both capital and interest. Commercial banks pay 5 per cent only on their interest. Development finance institutions do not pay any turnover tax whatsoever.

There seems no reason why the disparity should not be abolished by charging the development finance institution a 3 per cent turnover tax on their leases. No longer can it be argued that they are playing an exclusive developmental role and should therefore be given preferential treatment. It is well known that among their biggest customers are some multi-nationals and large Sri Lankan companies to whom they lend in competition with the commercial banks. As far as leasing is concerned, development finance institutions are in direct competition with leasing companies over whom they have the advantage of both concessionary funds and preferential taxation.

The suggestion that the Government should levy 3 per cent on leasing done by development finance institutions has the added merit of broadening the tax base (thereby increasing government revenue) and levelling the unfair competition between the State (and para-statal institutions) and the private sector, a matter on which the International Bank for Reconstruction and Development and the Asian Development Bank have expressed strong views.

INTERNAL TRADE

There are two government organizations in charge of various aspects of internal trade in Sri Lanka - the Commissioner of Inland Trade and the Fair Trading Commission. They work together, as required by government policy, in

order to ensure that the consumer is not only protected from the anti-competitive practices of various dealers and shops, but also to see that consumer needs are supplied at a reasonable price and quality.

For a long time, unlike some developing countries, Sri Lanka had in place a well-established distribution system throughout the island, managed by both government organizations and the private sector, covering rail and road transport, and having local agents to distribute goods. The cooperative organization has its own distribution system throughout the country. In the war-torn areas in the north and north-east, however, the distribution system had nearly broken down during the past few months.

The cooperative organization with its sales outlets in every part of the island offers keen competition to the private sector. When traders see the quality of goods and the prices at which they are sold by the cooperative shops, the private sector finds it difficult to sell at a high price or unload substandard goods. In addition to the cooperative outlets and the private shops, there are weekly Sunday fairs in every part of the country. These give consumers an opportunity to obtain their weekly requirement of goods, including food items. Sunday fairs also provide an opportunity for villagers, and townspeople to sell their excess supply of garden crops at a reasonable price. No registration or licence is required to sell such items as home-made garments and similar articles. They have only to pay the local costs to the local authorities who control these trade fairs.

No system has been organized by the Government or by any responsible association to collect the produce of farmers, especially perishable fruits and vegetables which have to be disposed of within one or two days of harvesting. Farmers have to sell their produce to the local collectors on credit. The local collectors send them to the dealers in the central market where they have to obtain the assistance of the market operators. The farmer gets his money only after the sale of his produce at the central market and deduction of various commission charges, transport costs, etc. Very often the farmer does not get even one-fourth of the selling price. Under this system, the farmer has no alternative but to accept whatever price the local collectors will pay. These local collectors operate areawise, and therefore there is no competition among them at all.

The position in regard to spices is even worse. Local collectors go on advancing money to farmers so that they may continue to be indebted to them and give their crop at whatever price the collector offers. The international price or the export price is not reflected at these buying points. Under the new development policy measures, the Government has now taken a decision to establish buying centres in the producing areas which can have direct contact with exporters and wholesalers.

TIED PURCHASING

Tied purchasing from a firm related to the parent company is not unusual. Some firms purchase their raw materials from sister companies at special prices. If firm X is asked whether the raw materials it purchases from its sister firm Y would be available to other firms at the same price, Xreplies that firm Y produces the raw materials it needs according to a special formula to ensure the quality of the product. Naturally firm X would not want raw materials made to its formula to be offered to its competitors.

COLLUSIVE TENDERING

Government purchases have to be made on a tender basis, except for day-to-day requirements of low cost miscellaneous items. All imports by the Food Commissioner's Department and the Fertilizer Corporation are made on a world-wide tender basis. The Government has appointed Tender Boards to go through the tender procedure, to examine the offers received and to make purchases from the most favourable source. Apart from the considerations of price they have to give equal weight to delivey terms and the quality of goods. Government organizations have to award contracts by tender in other areas as well.

There have been collusive offers by suppliers on these tenders. As a buyer, the Tender Board had to ignore such practices and take the most favourable offers. Offers on tender for construction of building complexes, roads and development projects come very often with financial assistance, gifts of machinery and loans. Here again the Tender Board has to award the tender on merit alone.

There are regular purchases by the Government organizations for which they have to select the supplier on tenders annually. One good example is the requirement of meat for the zoo: very often it is the same supplier, who is in a position to get the supply organized, who is the one awarded the contract. It is difficult to prevent this practice, as the buyer has to assure an uninterrupted supply at a reasonable price. Nevertheless, whenever the tendering authority finds that the offers received are not competitive, it has the right to cancel the tender.

According to the Head of the Government supplies organization, collusive tendering has been practised in the past by suppliers of electric bulbs, PVC wire, blackboard chalk, sealing wax and a few others.

The one and only tenderer for the supply of automotive batteries has quoted the same price for the past few years. In some instances, owing presumably to a tacit agreement between the suppliers, only one firm tenders in response to the invitation to tender, for example for PVC pipes, PCV cables, etc. In another instance, such as for the manufacture and supply of sealing wax, both firms quoted an identical price. This could indicate collusion between them. When tenders are used for the supply of PVC wire, only one firm, submits tenders, although there are two large firms - Associated Cables and Kelani Cables - in this industry.

In the construction industry so far there has been no evidence of collusive tendering among local contractors for locally-funded projects. Competition is so severe that tenderers have been known to quote well below the Government engineer's estimates. In some cases, quotations were only 60 to 70 per cent of the estimated cost of the project.

However, in the case of projects funded by foreign agencies - Asian Development Bank (ADB), the International Bank for Reconstruction and Development (IBRD) and the OCEF - the funding agency, in consultation with the department concerned, makes a short list of some five firms among those expressing interest in the project, but, finally, only one of these actually puts in a tender. This could be considered collusion.

INTERNATIONAL TRADE

As a member of a number of international organizations and service organizations, Sri Lanka has to maintain certain standards. Nevertheless, some aspects of Sri Lanka's export trade have to be commented on here.

Reference was made earlier to the tea auction system where everyone can obtain their requirement of tea of various grades for a particular blend at the same price. But what happens thereafter is quite different. Some exporters of tea offer the same blend as that supplied by their friends (who participated at the auction) to their buyers at a lower price, sometimes even below the cost. Though international trade depends on friendship and confidence built up over the years, there are some buyers, particularly new buyers, who would like to obtain quality grades at a lower price. Very often exporters succeed in obtaining supply contracts from such buyers abroad. They send one or two shipments of high quality grades then gradually lower the quality by using a higher percentage of low-quality tea in the blend in order to cover costs and maintain a profit margin. In so doing, the country's image abroad as a reliable supplier becomes tarnished. Sri Lanka has lost several buyers abroad because of such practices by some exporters. There is provision to blacklist these exporters, but it is very seldom that foreign buyers actually complain about them. This is not an issue of competition, however, but rather one of controlling fraudulent activities and substandard goods.

In the past, a shortage in weight of some exports, particularly of cinnamon, has been observed when it reaches low humidity countries in the North, even though shippers have kept to the correct weight at the point of shipping. Certain produce becomes drier after arrival in a low humidity climate. In order to overcome this shortfall in weight, the Government is nowpermitting a certain percentage over and above the weight to cover this loss. Such practices are acceptable in international trade although, at first glance, they may seem to be unfair trading practices.

OCEAN FREIGHT

In the early 1970s, Sri Lanka faced numerous difficulties in obtaining cargo space for export goods both in conference and liner vessels, particularly for dirty cargo such as coir fibre, graphite and coconut shell charcoal. Not only did shipowners refuse to carry them but there were frequent increases of general freight rates which made Sri Lankan exports uncompetitive on foreign markets vis-à-vis similar goods on the same market from competitors. Official representations made to shipowners produced very little results. Sri Lanka shippers were forced to accept these increases as they did not have any alternative. In order to overcome this situation, the Government established the Ceylon Shipping Corporation in 1971 and purchased a few vessels.

The next step taken by the Government was to establish a Central Freight Bureau, in 1973, with a view to providing a central freight booking office for allocation of space for goods on any vessel to be shipped from Sri Lanka's ports, ensuring aggregation of cargo in economic loads, rationalizing regular services for the shipment of cargo and fostering the national merchant fleet. Other objectives were improving Sri Lanka port performance, loadingrate, handling of cargo, negotiations with shipowners and shipping lines on freight rates, surcharges, adequacy, frequency and efficiency of shipping lines for carriage of cargo from Sri Lanka ports, reducing costs by shippers and undertaking research on shipping which would, in the long run, help shippers and promote Sri Lankan exports abroad.

Since the establishment of the Central Freight Bureau, shippers have not had much difficulty in obtaining shipping space for their cargo at a reasonable, established rate of freight. However, the foreign shipowners and their local agents began to protest when they could not enjoy the same benefits as before. The Sri Lanka Shippers' Council worked in close association with the Central Freight Bureau as they experienced a spectacular and unprecedented increase in shipping opportunities. Earlier, they had found it difficult to obtain space on vessels calling at Colombo Port. Following the establishment of the Central Freight Bureau, the very same vessels were competing to obtain cargo through the Bureau.

Under the liberalization programme of the present Government, ocean freight was also liberalized with effect from 1 January 1990, except for the northern European sector. Immediately after the liberalization of freight, sharp competition began among the steamer agents to secure cargo for the vessels they represented; as a result, freight rates have dropped by about 30 per cent. This lower rate may not last long. Already Ceylon steamer agents have given notice to the Shippers' Council of an increase in freight rates. These increases are likely to come in stages with no competition among themselves and gradually they may move back to the old practice of offering rebates and discounts to the shippers and transferring the rebates in foreign exchange to bank accounts abroad - a restrictive business practice.

RESTRICTIVE BUSINESS PRACTICES IN AIR TRANSPORT

Commercial airline operations - whether passenger or cargo, both to and from Sri Lanka - are subject to the approval of the Director of Civil Aviation who, in turn, decides on the recommendation of Air Lanka Limited, the national carrier.

Air Lanka presently operates three L10 Lockheed and one Boeing 737 aircraft on the following routes:

(a)	European services:	London, Paris, Frankfurt, Zurich, Amsterdam, and Rome;
(b)	Middle East services:	Dharan, Riyadh, Kuwait, Bahrain;
(c)	Indian sub-continent:	Karachi, Bombay, Madras, and Trivandrum;
(d)	South-east Asia and Australia:	Bangkok, Kuala Lumpur, Singapore, Melbourne and Sydney;
(e)	Far East:	Hong Kong, Tokyo.

Aircraft schedules are very tight and are heavily dependent on good maintenance facilities and ground handling operations.

With regard to passenger movement, several European tour operators have complained about:

(i) The unsuitability of Air Lanka's departure and arrival times for flights from Paris and Amsterdam for tour groups to Sri Lanka. Therefore, they have requested traffic rights to operate their own charters. This request seems to have been rejected by Air Lanka. Since the tour operators will create new markets, Sri Lanka's hesitancy may stifle competition and restrain the growth of the tourist industry.

(ii) There have been continuous complaints from Pakistan International Airlines against the restrictions imposed on their uplifts ex-Sri Lanka.

(iii) In view of the restrictions which Sri Lanka wanted to introduce, Singapore Airlines changed their operational patterns to Sri Lanka. At present they only operate flights from Sri Lanka to Singapore and vice versa. Sri Lanka has lost Singapore Airlines' contribution to the Sri Lanka tourist industry from European destinations.

With regard to cargo transport, Sri Lanka exporters are adversely affected by the following:

(i) Air Lanka does not operate specialized cargo charters. The export industry would welcome regular freight operations which will enable exporters to be flexible. In fact, the Flying Tiger Airline offered to operate regular freight services to Colombo. On account of Air Lanka's objection, these flights were diverted to Bangkok. Thailand's air capacity expansion is closely linked to her export boom.

(ii) It is not possible to obtain flight space from charter/freighters with short notice and every year during the high season Sri Lanka exporters experience great difficulty for want of space. This has affected adversely the export drive of the country.

(iii) Air Lanka does not permit charter/freighters to bring inbound cargo. Since freight operators quote rates based on the utilization of space, this too increases the ultimate cost to the exporters.

(iv) Air Lanka's handling charges at the airport seem to be excessive. Since it has a monopoly on handling in Colombo, no controls are exercised. This makes operators shy away from Colombo as a point of flying operations.5/

MARKET RESEARCH

Market research abroad for Sri Lanka's exports is efficiently carried out by our commercial representatives abroad. Their market research covers the entire area for a product, including packaging requirements, health standards and quality. This research helped Sri Lanka to introduce a large range of new products to the foreign market. These market survey reports are made available to exporters, various trade associations, and even to universities at their request, free of charge. Market research is done by the Export Development Board as well, covering both the local availability of a product and the market potential for a product abroad. Few anti-competitive practices have been uncovered in the market research reports we have seen.

AUDITING

It is a requirement under the Finance Act No.39 of 1971 for the Auditor General to audit all Government corporations and business undertakings every year for the purpose of highlighting deficiencies and shortcomings of the organization. Under section 13 (17) (a) of the Act his audited report has to be submitted to the Public Accounts Committee. Any cash surplus has to be deposited in the Treasury.

Private sector auditing of companies is quite different. Every company registered with the Registrar of Companies has to file its audited accounts annually with the Registrar. These companies are audited by registered, professionally qualified accountants and their auditing helps the company to improve its operations and income. We have not discovered any restrictive business practices in the field of auditing.

NOTES

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CORPORATE POLICIES IN THE REPUBLIC OF KOREA

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Note:

Through accession of the German Democratic Republic to the Federal Republic of Gemany with effect from 3 October 1990, the two German States have united to form one sovereign State. As from the date of unification, the Federal Republic of Germany acts in the United Nations under the designation "Germany".

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CORPORATE POLICIES IN THE REPUBLIC OF KOREA

INTRODUCTION

The Republic of Korea has attained highly successful economic growth in the past couple of decades, thanks to the concerted efforts of all economic agents. The history of the country's economy can be illuminated from many different angles, but for the present purposes an examination of the evolution of corporate policies in the course of economic development would seem the most expedient approach. Corporate policies are the instrument of government and business, the two principal actors in economic growth. It is through such policies that these actors interact in response to changing economic conditions.

Following independence in 1945 western capitalism and democratic political institutions were introduced in the Republic of Korea, where feudalistic bureaucracy had been the rule for centuries. A harmonious combination of capitalism and democracy could not be achieved effectively since the country was devastated by the Korean War. It later realized its national goal of economic development under the direct supervision of the Government. In an attempt to achieve rapid growth, economic activity in the private sector was directed more by government will than by individual choice. Consequently, government intervention in the private sector became ubiquitous, and, despite private corporate ownership, Korean firms could not be considered capitalistic in the true sense of the word.

Up to the 1970s the Government of the Republic of Korea took charge of the overall operation of the economy, with private firms playing a rather passive role. In general, corporate policies during this period purported to provide direct assistance, while imposing regulations, to selected industries and firms. Moreover, from 1975 to 1979 in the aftermath of the oil crisis, the Korean Government tightened its control of the economy by enforcing widespread price controls.

As the economy expanded and became more complicated and diversified, however, direct government regulation grew less effective and was often detrimental to autonomous industrial growth. The rationale for government intervention was further weakened by improvements in the capabilities of the private sector. Moreover, the growth-first policy widened the imbalances among industries, regions and income classes and occupations.

In these circumstances, the Korean Government realized that the market mechanism rather than government planning should play the key role in allocation of resources. The Government then addressed these issues by launching a "liberalization" policy in various economic areas, while bringing the importance of equity or balance to the forefront. Most notably in the area of industrial policy, it expanded the scope of import liberalization and promoted competition among domestic firms. Accordingly, the importance of industrial organization loomed large, while previously the upgrading of industrial structure had been dominant.

This particular period signified a turning point in which the "government-led" economy, prevailing up to the 1970s, began to be transformed into a market economy. The basic tenet of corporate policies changed also from direct preferential intervention to indirect general incentives. This fundamental shift in policy orientation has accelerated in line with the growing demand for political and economic democratization since 1988.

It was only a beginning, however. The Republic of Korea now faces the task of restructuring its economy to prepare for becoming an advanced country early in the next century. This will require not merely a change in industrial structure to carry out such a transformation physically, but will also call upon an array of institutional and organizational innovations necessary for creating a full-fledged free-market economy.

In view of both external and internal factors, the Republic of Korea cannot continue its growth along a path extrapolated in linear fashion from its past. It must launch itself into a new dimension in which its economy is run by a new modus operandi, putting more emphasis on the market principle. This implies that corporate policies should be recast to reflect this functional change in the relationship of government-business. In particular, the Government should gear up to a rationalization of its administrative organization commensurate with the changes anticipated in its future functions and roles. In doing so, it will have to draw on its past experience with corporate policies. Subsequently, the efforts made may in turn offer an example to other countries.

This paper will first examine some of the policy issues regarding direct foreign investment and technological licensing. This will be followed by a brief discussion of the recent trends in industrial support and economic regulation. The major characteristics of industrial organization will then be illustrated followed by a sketch of the evolution of competition policy. Finally, an attempt will be made to explore the implications of the Korean experience.

I. DIRECT FOREIGN INVESTMENT AND TECHNOLOGICAL LICENSING

The role of foreign technology has been essential to the development of domestic technological capability in the Republic of Korea. There are many ways in which foreign technology is transferred, but direct foreign investment (DFI) and technological licensing (TL) are the more important ones. In 1960, the Foreign Capital Inducement Act came into force to attract foreign investment. This Act has been amended several times, reflecting changes in the underlying philosophy of government policy toward foreign capital. Before going into the details of the law, an overview of DFI and TL will be given.

Although table 1 does not emphasize the trend, on a total approval basis, the inflow of DFI had increased very rapidly until 1973, when the Government applied stricter criteria in allowing DFI. The flow of DFI thereafter stagnated until the end of the 1970s, then began increasing again rapidly in the 1980s owing to the change in the law and the improved investment environment. The flow of TL shows a similar pattern. Nevertheless, the share of DFI in the net flow of long-term private capital was not more than 5 per cent during the 1980s, while it was around 60 per cent for Singapore and 70 per cent for Taiwan, Province of China, during the same period.

Table 1. Trends of DFI and TL, 1962-89 (total approval basis)

	DFI		TL	
	Number of cases	Value	Number of cases	Royalties
1962 - 66	39	47.4	33	0.8
1967 - 71	360	218.6	285	16.3
1972 - 76	867	879.4	434	96.5
1977 - 81	251	720.6	1 225	451.4
1982 - 86	579	1 767.7	2 078	1 184.9
1987 - 89	1 074	4 616.2	2 151	2 129.6
TOTAL	3 170	7 067.1	6 206	3 879.5

Note: The value of DFI and royalty payments are in millions of current $US.

The relative stagnation of DFI in the Republic of Korea during the 1970s and early 1980s may be ascribed to the country's policy toward DFI. In this period, the Government adopted strict policies to regulate the quality of DFI, resulting in greater reliance on loans as a source of foreign capital and on TL as a source of technology. This policy in effect gave rise to the unpackaging of capital and technology.

Table 2 shows that Japan was by far the largest source of DFI and TL in the Republic of Korea, with the United States a distant second. These two countries accounted for more than two thirds of the total in both types of foreign investment. A recent survey has shown, however, that Japanese investment tended to be concentrated in low-technology industries, in contrast to American investment.

Table 2. Distribution of DFI and TL by Country (1962-89)

	United States	Japan	Germany Fed. Rep	United Kingdom	France	Others	TOTAL
Number of TL	1 477 (25.6)	2 974 (51.6)	320 (5.6)	198 (3.4)	236 (4.1)	557 (9.7)	5 762 (100.0)
Number of DFI	717 (22.7)	1 922 (60.6)	99 (3.1)	51 (1.6)	39 (1.2)	342 (10.8)	3 170 (100.0)
Value of DFI	1 940.9 (27.5)	3 553.7 (50.3)	223.4 (3.2)	181.6 (2.6)	141.9 (2.0)	1 025.6 (14.5)	7 067.1 (100.0)

Notes: The value of DFI is in millions of current $US.
Figures in parentheses denote percentage shares.

Table 3 shows that until 1989, the manufacturing sector received 78.9 per cent of DFI and 90.7 per cent of TL in terms of the number of cases approved. Among the manufacturing subsectors, "strategic industries", including oil refining and chemicals, electric and electronic machinery, general machinery, and transportation equipment, absorbed the largest portion of foreign capital. These four industries accounted for 56.3 per cent and 78.2 per cent of the total number of DFI and TL, respectively. The influence of government policy is apparent in this pattern of industrial distribution of foreign investment.

Returning to the discussion of government policy toward foreign investment, the original Foreign Capital Inducement Act provided tax preferences, equal treatment with domestic firms, guarantees of profit remittance, and withdrawal of principal for foreign investors. Furthermore, incoming foreign firms were not required to find domestic partners for the venture, provided that they caused no injuries to the national interest. This liberal policy toward foreign investment lasted until 1973, when this Act was amended to control the quality of foreign investment. The Act accorded a higher priority to joint ventures than to direct foreign investment. At the same time, the General Guidelines for Foreign Direct Investment were adopted.

Table 3. Distribution of DFI and TL by Sector (1962-89)

	DFI		Number of Cases of TL
	Number of Cases	Value	
Agriculture and Fisheries	80 (2.4)	35.2 (0.5)	31 (0.5)
Mining	43 (1.3)	14.5 (0.2)	- -
Manufacturing	2 501 (78.9)	4 565.7 (64.6)	5 172 (90.7)
Textiles & fibre	223	258.1	316
Oil refining & chemicals	316	1 019.0	999
Metals	171	165.4	354
General machinery	419	426.2	1 540
Electric & electronic machinery	559	1 123.4	1 322
Transportation equipment	113	643.3	185
Services	466 (14.7)	2 451.8 (34.7)	499 (8.8)

Note: The value of DFI is in millions of current $US.
Figures in parentheses denote percentage shares.

The Guidelines specified the following projects as ineligible for approval: (a) projects disrupting domestic demand and supply of raw materials and intermediate products; (b) projects competing in overseas markets with domestic firms; (c) projects aiming solely at providing financial support for existing domestic firms; and (d) projects intended solely for profiting from land use. The Guidelines also limited the foreign participation ratio to 50 per cent, except in the following cases: (a) exclusively export-oriented projects that did not compete with domestic firms in the overseas markets; (b) technology-intensive projects that produced important export- or import-substituting products; (c) desirable projects by multinationals investing only in the form of wholly-owned subsidiaries in other countries; (d) projects that contributed to the rationalization of the domestic industrial structure and were beyond the capacity of domestic investors, owing to huge capital investment requirements or the advanced technology involved; (e) projects from a country expected to increase substantially its future participation; (f) projects by nationals abroad; and (g) projects in the Free Export Zones and other specific industrial estates designated by the Government. In addition, local participation of more than 50 per cent was required for the following types of foreign investment: (a) labour-intensive projects, (b) bonded processing projects, (c) projects dependent on domestic resources for major raw materials, and (d) projects oriented toward the domestic market.

The Government of the Republic of Korea has gradually liberalized its policy toward DFI since 1980. The Foreign Capital Inducement Act was amended in 1983 to encourage DFI. One of the most important changes was the introduction of a "negative list" system for determining which industries were open to DFI. Under this system, only those industries on the list were prohibited or temporarily restricted from foreign investors, while all other industries were eligible for DFI. In 1990, of the 999 industries included in the Korean Standard Industrial Classification System, only 208 industries (51 prohibited and 157 restricted) appeared on the negative list. The proportion of liberalized industries (791) has now reached 79.2 per cent, a substantial increase from the 521 industries permitted under the old positive list system.

Prohibited industries, completely closed to DFI, include those: (a) run by the Government or public enterprises, such as water supply and sewage, the postal service, the telecommunications service, railway transportation, and cigarette and red ginseng manufacturing; (b) harmful to public health or to the environment; (c) detrimental to national culture and social custom, such as gambling; and (d) designated by Presidential decree, such as newspaper publishing, radio broadcasting, and grain cultivation.

Restricted industries are not open to DFI in principle, but exceptions may be made on a case-by-case basis. Exceptions include industries which (a) receive special support from the Government, (b) are energy-intensive or consume a significant amount of imported raw materials, (c) generate pollution, (d) produce luxury goods, (e) affect the livelihood of farmers and fishermen, and (f) invest in infant industries deemed to require protection for a certain period of time according to industrial policy.

Another significant change was the adoption of an automatic approval system. Projects which (a) are not on the negative list, (b) have a foreign equity share of less than 50 per cent, (c) involve foreign investment amounting to no more than 1 million United States dollars, and (d) do not require tax exemption will be immediately and automatically approved. Furthermore, restrictions on the proportion of equity owned by foreign investors have been relaxed to a great extent, whereas various tax advantages given exclusively to all foreign investments have been reduced considerably in order to bring about fair competition between foreign and domestic firms.

Technological licensing is also covered by the Foreign Capital Inducement Act. The 1966 amendment of the Act made all TL subject to prior approval by the Government. The following general guidelines were introduced to supplement the Act: (a) those projects that promote exports, develop intermediate products for capital goods industries, or have a diffusion effect on other sectors were given higher priority; (b) the royalty payment was not to exceed 3 per cent of sales; (c) contract expiration was to be less than three years for the manufacturing sector; and (d) export restrictions were prohibited.

Since the early 1970s, however, restrictions on TL have gradually been relaxed. In 1979, the ceiling on royalties, the limit on contract duration, and the prohibition of export restrictions were abolished. Nevertheless, TL falling under the following categories was still not approved: (a) those aiming primarily at the licensing of an exclusive sales right, (b) those

intended primarily for the sales of raw materials or parts, (c) those including substantially unfair practices such as restrictions on export conditions, and (d) those intended to introduce technologies equivalent to those protected by the Government for domestic development.

In the late 1970s, the administrative procedure for approving TL was simplified to allow automatic approval for those arrangements meeting certain quantitative criteria. Moreover, in 1984, the approval system was replaced by a reporting system. Firms wishing to import foreign technology need now only report their intention to the ministry concerned. If the ministry makes no objections and requests no additional information or changes within 20 days after the report has been filed, the TL in question will be regarded as accepted.

The Government planned to accelerate further its liberalization policy toward foreign investment starting in 1991. The approval system for DFI would be phased out gradually through three stages by 1993, to be replaced completely by the reporting system, under which a proposed DFI, unless it related to restricted or prohibited industries, would be approved automatically after 30 days. However, within the category of liberalized industries, (a) weak domestic industries specifically designated for small- and medium-sized firms, such as umbrellas and bags, (b) distribution industries including retailing, and (c) industries designated for industrial rationalization will continue to be subject to approval, as in the present system.

At the same time, the Government will not accept proposed DFI, if it threatens to: (a) disrupt national security or public order, (b) be detrimental to public health (including the environment), national culture or social custom, (c) establish a monopoly or a market-dominating position in the domestic market, or (d) violate the Act Concerning Monopoly Regulation and Fair Trade (hereafter, called the "Fair Trade Act").

All in all, when the proposed liberalization programme has been completed in 1993, almost 99 per cent of the manufacturing industries, or 80-90 per cent of all industries, will be covered by the reporting system. In return for the broadened scope of liberalization, however, the Korean Government will further curtail tax deductions and exemptions for DFI to let foreign investors stand on an equal footing with domestic competitors.

The business conduct of all firms in the Republic of Korea, whether foreign or domestic, is subject to Korean law. In addition, international contracts concerning (a) technical licensing, (b) loans, (c) joint ventures, (d) import agency, (e) copyright, (f) long-term import and (g) technological consulting services are covered by two legal systems. The technical details for each type of contract are dictated by relevant individual laws, including the Foreign Capital Inducement Act, while their anti-competitive or unfair practices clauses are covered by the Fair Trade Act.

The Fair Trade Act requires all business firms and trade associations to report to the Fair Trade Commission (hereafter, "FTC") within 30 days of concluding international contracts. The FTC is empowered to take necessary measures to amend those clauses entailing undue cartel activities, unfair

business practices or resale price maintenance. Table 4 shows that the FTC has corrected 1,546 contracts, 24.5 per cent of a total of 6,316 which it examined during the period 1981-1989. The share of technological licensing in the total number of contracts examined was 64.4 per cent, but accounted for 83.1 per cent of the total number of amended contracts.

Table 4. International Contracts Reported to the FTC (1981-89)

	Reported	Amended	Approved
Technological Licensing	4 070	1 286	2 784
Loans	170	6	164
Joint Ventures	1 043	170	873
Import Agency	395	83	312
Copyright	638	1	637
TOTAL	6 316	1 546	4 770

This high frequency of amendments attests to the Fair Trade Act's role in strengthening the bargaining power of Korean firms vis-à-vis their foreign contractual counterparts. Originally, when this Act was first drafted in the late 1970s, it was thought that its application to international contracts would dampen the inflow of foreign capital. However, the records clearly show that this has not been the case.

As indicated earlier, Japan and the United States have been the two largest sources of technological licensing in Korea. Table 5 shows that Japan and the United Statess accounted for 47.9 per cent and 27.2 per cent, respectively, of the total number of technological licensing contracts. The share of the number of amended TL contracts in the total is 31.6 per cent, 34.6 per cent in TL with Japan and 29.5 per cent for the United States.

Table 5. Distribution of TL reported to the FTC by country (1981-89)

	Reported	Amended	Approved
Japan	1 951	676	1 275
United States	1 108	327	781
Germany, Fed. Republic of	245	68	177
Others	766	215	551
TOTAL	4 070	1 286	2 784

International business contracts will play a more important role as Korea expands her economic interface with foreign firms in the coming years. In order to facilitate the inflow of foreign capital and technology, therefore, the Government has revised the Guidelines for Unfair Business Practices in International Contracts, in July 1990. These guidelines specify the patterns of and criteria for unfair business practices for each type of international contract.

Although unfair business practices are most conspicuous in technological licensing, all contracts reported to the FTC until 1989 will be investigated in this study, since clauses prescribing such practices can be stipulated in any type of international contract. The results are summarized in table 6. As a single contract sometimes contained more than one unfair clause, the figures do not correspond to the number of contracts amended. In any case, the incidence of unfair clauses by country was more or less the same as the distribution seen in table 5, namely, 49.4 per cent and 27.7 per cent for Japan and the United States, respectively. The patterns of unfair practices were not very different among countries. The most common were restrictions on geographic markets, restrictions on the use of the transferred technology after the expiration of the contract, and requirements for the unilateral transfer of improved technologies to foreign investors.

Table 6. Unfair clauses in international contracts (1981-89)

	Japan	U.S.	Others	TOTAL
Restrictions on raw materials and parts	115	36	46	197
Restrictions on geographical markets	352	133	146	631
Restrictions on marketing channels and methods, sales quantities and prices	30	18	24	72
Restrictions on handling competing products or technologies during the contract period	35	27	15	77
Restrictions on handling competing products or technologies after the expiration of the contract	1	-	1	2
Restrictions on utilizing transferred technologies after the expiration of the contract	207	149	96	452
Unilateral determination of royalties	1	-	-	1
Forced royalties on non-contract technologies	7	12	3	22
Undue delay of technology transfer	-	-	1	1
Unilateral determination of mandatory sales promotion expenditures	-	5	5	10
Unilateral determination of arbitrators	-	2	1	3
Unilateral transfer of improved technologies	163	228	184	753

II. INDUSTRIAL SUPPORT AND ECONOMIC REGULATIONS

As earlier mentioned, the Government of the Republic of Korea has intervened quite extensively in the private sector in order to stimulate industrial growth. One such type of intervention was the business licensing system, which not only restricted the number of firms in specific industries but also regulated their business activities. Such an important restriction was understood as inevitable for allocating limited resources in the initial period of economic development. At the same time, the Government provided various programmes of industrial support and incentives for these firms.

Some of these programmes were put into effect with the force of general laws for industrial policy relating to banking, credit, tax, and trade. In addition, the Government introduced regulatory laws designed specifically for individual industries in order to tailor policy measures more effectively to their particular needs. Such laws numbered more than 700. Of course, not all of these laws were necessarily aimed at economic regulation, but contained elements of social regulation as well. It cannot be denied, however, that economic regulation, mostly in the form of government-imposed restraint of competition, was the hallmark of the development era in the Republic of Korea.

With the rapid economic growth and the remarkable expansion of corporate capabilities, economic regulations have now begun, in fact, to contain the engine of growth. Concurrently, industry-specific preferential support has lost much of its rationale as the economy has come under greater regulation under the market principle. Moreover, such a policy could engender criticism of "industrial targeting" by foreign trading partners. Based on this perception and further aided by the ongoing liberalization movement, the Government of the Republic of Korea has embarked upon economy-wide deregulation policies since the mid-1980s.

One of the first such moves was the enactment of the Industrial Development Act in 1986. This Act nullified seven previous acts, covering machinery, shipbuilding, electronics, iron and steel, non-ferrous metals, petrochemicals and synthetic fibres. The new Act's industrial coverage is far more extensive, covering practically all manufacturing industries. Nevertheless, the Act represents a new philosophy of industrial policy. First of all, when a certain industry is designated for "rationalization", it can benefit from government assistance and engage in necessary, concerted industry-wide activities, but this applies only up to three years. Thus the Act is a sharp contrast to previous laws that specified no such time limit.

Furthermore, rationalization measures are differentiated for two different categories of industries. The first category contains industries in which: (a) productivity can be raised substantially through improvements in technology or equipment; (b) resources can be saved and value-added increased considerably; and (c) common bottlenecks in production and management can be remedied. The second group includes industries in which inadequate managerial size, production scale or method would long persist owing to changes in the economic environment, including the industrial structure. Industries characterized by the first designation are commonly termed "sunrise" industries, while those satisfying the second description are "sunset" industries.

Rationalization programmes for sunrise industries must include plans for (a) technological development, (b) upgrading of product quality, (c) optimization of production scales, (d) product specialization by firms, and (e) other necessary cartel activities. Those programmes for sunset industries must include plans for (a) the disposal of excess capacity, (b) the restriction of increases and renovations in production facilities, (c) the optimization of managerial size, (d) production scale or production method, (e) business combinations such as mergers and acquisitions, (f) changes in business lines, and (g) other necessary cartel activities. One can, therefore, infer that rationalization programmes for sunrise industries may have fewer anti-competitive effects than those for sunset industries.

Since July 1986, eight manufacturing industries have been designated for rationalization: (a) fabrics, (b) automobiles, (c) alloy iron, (d) diesel engines for vessels, (e) heavy electrical machinery, (f) heavy construction equipment, (g) dyeing and (h) fertilizer. Of these, the rationalization programme for fertilizer was approved later than others and remains effective until the end of 1990. Rationalization programmes for all the other industries except fabrics were terminated in 1989. There are several reasons for the exception of fabrics. The fabric industry in the Republic of Korea, a major export industry, is dominated by a large number of small- and medium-sized firms which suffer from chronic excess capacity and technological stagnation. Moreover, most of these firms are concentrated in a particular area, so that their bankruptcy would entail serious political repercussions as well.

Although these eight industries vary in such attributes as capital intensity and potential for growth, they display the same characteristics of excess capacity. Consequently, one common trait of their rationalization programmes has been the prohibition of new entrants. This prohibition represents the most serious form of institutional entry barrier, and hence, may be justified only by an overriding public interest. Fortunately, all of these industries have shown a fair sign of recovery or growth.

So far, the Government has been quite successful in designating only a limited number of rationalization industries and also in maintaining the three-year time limit. This performance reflects the Government's will to abide by the market principle and signifies a major departure from past industrial policy. In so far as the primary justification for government intervention is the duplication of investments by firms, more attention will be given to inducing the autonomous adjustment of private firms through the dissemination of relevant information.

Shortly after the Industrial Development Act was put into effect, the Government of the Republic of Korea began to deregulate a number of important industries. Since economic regulation tends to protect the vested interests of "regulated" firms vis-à-vis potential entrants, these regulated firms may oppose any serious proposal for deregulation. Government regulatory authorities are also disinclined to deregulate, since they may consequently lose their administrative power. It is, therefore, a difficult task to dissolve this community of interests formed by government and business.

Deregulation, or rather rational reformulation of regulation, is essential for enhancing not only economic efficiency but also for achieving social transparency. As the Uruguay Round approaches its final stage, deregulation, coupled with import liberalization, is emerging as an imminent and practical task for the Government. Successful deregulation will also bring about a "small government", in the sense that the Government efficiently does only what it should.

In the Republic of Korea, the Fair Trade Commission initiated deregulation policy because of its close relation with fair trade policy. Under the aegis of the Economic Planning Board, the most powerful agency for overall economic policy in the country, the FTC has been quite successful in ironing out deregulatory measures through consultations with other ministries concerned. The need for deregulation has been accentuated by a series of public hearings organized by the Korean Development Institute, illustrating the value of open debates in reconciling diverse opinions and conflicting interests.

Industries for which the Government has already implemented or prepared deregulatory measures include: alcoholic beverages, wheat flour, prepared animal feeds and other bean-based products, drugs and medicines, cosmetic products, agricultural chemicals, coal briquettes, petroleum refining, freight transportation, local and long-distance passenger bus transportation, automobile repair and inspection services, warehousing, maritime transportation, ocean-going fisheries, hotels, telecommunications, construction, technological consulting services, financing, insurance and stock brokerage. In addition, air transportation, tourist services, and professional services will be dealt with. Comprehensive deregulation will impose tremendous adjustment costs upon the country's economy, but is an inevitable task that the Republic of Korea must undertake for a second take-off. It is quite encouraging that in some consumer goods industries, the effects of deregulation can already be seen in the improvement of product quality and the lowering of prices.

III. INDUSTRIAL ORGANIZATION AND COMPETITION POLICY

A. Market structure and economic power

The basic strategy of rapid economic growth has tended to give higher priority to large rather than small- and medium-sized firms. However, this policy has led inevitably to monopolistic or oligopolistic market structure, concentration of economic power, and disruption of market functions. In order to cope with these problems, the Government has enforced a series of policies with varying degrees of success. Some key aspects of Korean industrial organization will be illustrated before policy measures are discussed.

Table 7 shows that the share of top-bracket firms of the total shipments or employment in the manufacturing sector had increased greatly in the 1970s. For example, the overall concentration ratio of the top 100 firms in terms of shipments increased from 44.6 per cent in 1970 to 46.8 per cent in 1982. The magnitude of concentration seems to be even more prominent considering that the number of firms substantially increased throughout this period. This observation tallies with government policy which strongly encouraged the establishment of large firms to take advantage of economies of scale in both heavy industry and the chemical industry during the 1970s. Since the early 1980s, however, overall concentration ratios, especially in terms of shipments, have decreased quite markedly, even taking into account a sharp decrease in the relative numerical weight of top-bracket firms. This may be partly attributable to the fact that during this period, medium-sized firms had grown relatively faster in the general machinery and electronics industries.

Table 7. Trends in overall concentration ratios (%)

	By shipments		By employment		Top 100 firms as percentage of manufacturers
	Top 50	Top 100	Top 50	Top 100	
1970	33.8	44.6	15.4	28.7	0.41
1977	35.0	44.9	16.9	23.9	0.37
1982	37.5	46.8	16.0	21.9	0.28
1987	30.9	38.9	14.5	19.8	0.19

The monopolistic and oligopolistic market structure seems to be the most obvious at the level of the commodity market. If a market in which the top three firms account for less than 60 per cent of the total share is defined as a competitive market, the ratios of such markets were around 15 per cent in terms of the number of commodities and 35 per cent in terms of shipments. It is noteworthy that the total number of commodity markets had increased by 618 between 1970 and 1977, whereas the number of competitive markets had increased by only 67. In other words, the 1970s may be characterized as a period in which the fast growth of the manufacturing sector was accompanied by an increase in monopolistic and oligopolistic commodity markets. This can be expected from a small economy at its initial stage of development.

Since the early 1980s, however, the trend has been reversed. Between 1977 and 1987 the number of commodity markets classified as monopolies and their share in total manufacturing shipments had declined substantially. More or less the same result may be found in cases of duopoly. This implies that new entries have occurred quite actively in markets which were previously monopolistic or duopolistic. Moreover, the shares of oligopoly and competition have increased both in terms of the number of markets and of

shipments. Therefore, by and large, the market structure of the manufacturing industries would appear to have become more competitive with the maturation of the Korean economy. Such a sharp contrast between the 1970s and 1980s is found in many other respects as well and not only in the economic sphere.

Table 8. Trends in commodity market structure

		Monopoly	Duopoly	Oligopoly	Competitive	TOTAL
1970	No. of Markets	442	279	495	276	1 491
		(29.6)	(18.2)	(33.2)	(18.5)	(100.0)
	Shipments (%)	8.7	16.3	35.1	35.9	100.0
1977	No. of Markets	667	425	674	343	2 109
		(31.6)	(20.2)	(32.0)	(16.3)	(100.0)
	Shipments (%)	16.3	11.0	33.9	38.8	100.0
1982	No. of Markets	533	251	1 071	405	2 260
		(23.6)	(11.1)	(47.4)	(17.9)	(100.0)
	Shipments (%)	11.4	6.6	50.6	31.4	100.0
1987	No. of Markets	533	277	1 173	655	2 638
		(20.2)	(10.5)	(44.5)	(24.8)	(100.0)
	Shipments (%)	7.8	7.7	40.2	44.3	100.0

Notes: Monopoly = CR1 > 80%, S1/S2 < 10, duopoly = CR2 > 80%, S1/S2 < 5.0, S3 < 5%, oligopoly = CR3 > 60%; and competitive = CR3 < 60%.
CRi and Si indicate, respectively, the i-firm market concentration ratio and the shipment of the top i-firm(s).
Figures in parentheses denote percentage shares of respective types of market structure in the total number of all commodity markets.

In addition to the generally high degree of concentration, competition was further constrained by various trade associations in the 1970s. Trade associations, whose number increased from 467 in 1970 to 1,026 in 1989, acted as a channel between the Government and individual firms in implementing the Government's industrial policies. Most trade associations, such as cooperatives of small- and medium-sized firms and exporters' associations, were established mandatorily by special laws. In many cases, these trade associations had big corporations in their membership, a factor not originally intended when the special laws were legislated.

It was generally pointed out that most trade associations tended to act collectively with questionable economic justification in determining price, adjusting production, restricting the number of new entrants into the industry. Other trade associations which were organized voluntarily, at least ostensibly so, engaged more or less in the same activities. These group actions were taken mostly under government administrative guidance, sometimes with the power of ad hoc laws for individual industries, or at least tacit understanding of the Government. This practice was accepted as a convenient means by both government and business, since the former had only to deal with a small number of trade associations while individual firms did not have to compete with one another.

A salient characteristic of the industrial organization of the Republic of Korea is the concentration of economic power, embodied in and symbolized by the "jaebol". The jaebol refer to the conglomerate business groups, the majority of whose component firms are monopolistic or oligopolistic in their respective markets, practically owned and controlled by particular individuals or close family members. Hence, the jaebol are characterized both by market concentration and by concentration of ownership.

Table 9. Trends in the share of business groups in total employment and shipments (% of total)

Business groups by size	Employment			Shipments		
	1977	1982	1987	1977	1982	1987
Top 5	9.1	8.4	9.9	15.7	22.6	22.0
Top 10	12.5	12.2	11.9	21.2	30.2	28.2
Top 20	17.4	16.0	15.1	29.3	36.6	33.9
Top 30	20.5	18.6	17.6	34.1	40.7	37.3

The relative sizes of business groups are shown in table 9. The share of the 30 largest groups in the manufacturing sector reached 17.6 per cent in 1987 in terms of employment and 37.2 per cent in terms of the value of shipments. The striking difference between their shares of shipments and of employment might be primarily the result of their capital-intensive method of production but partially their market power to manipulate commodity prices to some extent. Recently, their share of total shipments has tended to increase, while that of total employment has generally decreased.

Business groups could not expand rapidly by relying only upon internal growth. Additionally, they had not only to acquire existing firms, but also to establish new ones. Table 10 shows that the top 30 business groups owned 4.2 subsidiaries each on the average in 1970. This number jumped to 14.3 in 1979. It is worth noting that the number of new establishments was far greater than the number of acquisitions during this period, specifically, 202 in contrast to 135. During the same period, 1970 to 1979, the total number of manufacturing firms increased 1.3 times, while the number of subsidiaries of the top 30 business groups increased 3.4 times.

Table 10. Business integration of the 30 largest business groups, 1970-1982

	New establishment	Acquisitions	Internal mergers	Net increases	Number of subsidiaries
1970				126	
1971-79	202	135	27	303	429
1980-82	30	25	31	-27	402

Owing to the recession at the end of the 1970s and the consequent rationalization of business groups, the number of their divestures in the early 1980s surpassed the number of new entries, and business groups ended up with an average of 13.4 subsidiaries in 1982. In other words, for business groups, the 1970s witnessed an expansionary period, whereas the early 1980s brought consolidation. However, in the mid-1980s, business groups took over a number of failing firms and public enterprises, on the one hand, and began to establish new firms for industrial restructuring, on the other. Consequently, the average number of subsidiaries for the 30 business groups increased again, to 17.1 in 1989.

A fundamental source of the economic power of large business groups is their position in individual commodity markets. In 1987, the top 30 business groups competed in selling 1,499 commodities in 837 different goods markets. Their market positions are summarized in table 11. In 103 markets, a single business group had a monopolistic share of more than 80 per cent and, in 232 markets, a dominant share of 40-60 per cent. If we consider only the ranking of their market shares, the number of markets in which a single business group was ranked third or higher amounted to 941, or 62.3 per cent of the total cumulative number of markets where they participated.

Table 11. Market positions of the 30 largest business groups

Business groups by size	Market shares (%)					Ranking of market shares			
	0-20	20-40	40-60	60-80	80-100	1st	2nd	3rd	4th+
Top 5	345	141	82	38	42	224	133	68	223
Top 10	494	186	98	47	64	295	177	104	313
Top 20	738	250	136	69	94	410	256	141	449
Top 30	873	291	151	81	103	475	296	170	558

Almost all business groups in the Republic of Korea have their roots in the manufacturing sector, although many have recently expanded their activities into the financial sector as well, including banking, insurance, and stock brokerage services. Nevertheless, Korean business groups differ from the pre-war Japanese zaibatsu centred around banks in two ways. Firstly, the Republic of Korea's previously nationalized commercial banks were taken over by business groups only in 1981; secondly, no single legally acknowledged "identical person" was allowed to own more than 8 per cent of any bank's total stock. However, there has been no legal ceiling regarding ownership of local banks, and each is practically controlled by one single business group. Currently, 11 out of 27 stock brokerage companies are owned by individual business groups; by and large, the same is also true of life insurance companies. In all, 30 business groups own a total of 47 financial institutions.

The jaebol have yet another characteristic - the concentration of ownership. The most general method of concentrating ownership is intercompany shareholding. In 1984, the average intercompany shareholding ratio for the 30 largest business groups was 46.5 per cent. Subsidiaries of business groups are practically owned by particular individual shareholders and other firms they control. For example, table 12 shows that in the case of the top 10 business groups, an average of 46.4 per cent of total company shares are owned by particular individual shareholders and the firms they control. At the same time, less than 30 per cent of their subsidiaries have gone public in the stock market, and account for less than 60 per cent of business groups' total equity, on average. It may therefore be assumed that the jaebol still maintain quite a closed ownership structure.

Table 12. Ownership structure of the 10 largest business groups

Business groups by size	Shareholding ratios		Number of Firms	Equity
	By largest Shareholders	By Groups' Subsidiaries	Open/Closed	Open/Closed
Top 5	13.7%	35.7%	56/187=29.9%	56.6%
Top 10	14.7%	31.7%	139/514=27.0%	56.3%

The genesis of business groups may be explained by many elements. First, in the initial stage of the Republic of Korea's economic development, in which the markets for certain factors of production were not fully established, a particularly important role of entrepreneurship was obtaining and utilizing inputs that were not fully transacted in the market. By nature, however, the supply of entrepreneurship is not elastic. Moreover, it is not exhausted easily, despite repeated use. Because of these peculiarities, economic power is bound to be concentrated in the hands of a few entrepreneurs. Certainly in this regard, the Republic of Korea is no exception.

The concentration of economic power can also be traced to the diversification of business groups. While better manpower and physical resources were concentrated within monopolistic and oligopolistic firms, various structural and institutional barriers protected these firms' initial monopolistic market enclaves. The early monopolists and oligopolists expanded into new markets to make use of their excess capacity in manpower and capital that had accumulated as competitive pressures were eliminated in their already-existing markets.

The Government was also largely responsible for the concentration of economic power. Because strategic industries emphasized by the Government required a huge capacity in technology, capital, manpower, and organization, the jaebol were favoured over other firms. It was then natural that the benefits of the tax, credit and trade policies should accrue primarily to these business groups.

The concentration of corporate ownership, the other side of the issue, resulted to a great extent from the need for capital mobilization. In an economy where the general income level was low, inflation rampant and where other profitable speculative investment opportunities existed, it was extremely difficult for a firm to raise its required capital by issuing stocks to the general public. Furthermore, only rarely were the internal reserves of a firm sufficient to meet capital requirements of new investment projects, especially in capital-intensive industries. Hence, such rapid economic growth with a weak capital base rendered inevitable the high dependence of firms on external financing. As a result of this financing method, the ownership of business groups was not dispersed in the course of their growth. The concentration of ownership was also aggravated by the intercompany shareholding practice mentioned earlier.

The primary advantage enjoyed by business groups lies in synergy, or the economies of scope inherent in multiproduct activities. In the Republic of Korea, this was particularly relevant for the export drive and industrial restructuring of the past couple of decades. The advantages, enjoyed by the jaebol, however, may become disadvantages for other independent firms. For instance, although vertical integration by a business group tends to enhance its internal efficiency, such integration concurrently reduces the size of the market for other firms that had previously supplied this business group.

In comparison to independent firms, a subsidiary of a business group has greater bargaining power and a better market position in product markets and even greater power in factor markets. For example, a subsidiary has advantages in obtaining bank loans as a result of the artificial inflation of the subsidiary's capital base, through its connection with the entire group. Even if a subsidiary is not connected to its sister companies through intercompany shareholding, it can take advantage of the creditworthiness of the entire business group as well as profit from the group's personal contacts.

A subsidiary is, likewise, in a better position to attract high-quality manpower than an independent firm because of its social prestige, job security, and lifetime earnings, all of which may be ascribed to the large size of the business group as a whole. Furthermore, the synergistic effect in advertising and other marketing activities of each business group will induce more consumers to purchase the products of the group's individual subsidiaries. All these factors help a large business group to eliminate smaller independent competitors from the markets of its subsidiaries.

Another negative overall effect often observed in the past is the chain bankruptcy of an entire business group triggered by the financial failure of a subsidiary firm, owing to intercompany shareholding. This financial interdependence tends to build a high exit barrier; scarce economic resources are often inefficiently diverted to rescue a subsidiary from bankruptcy to avoid undesirable side-effects.

Bankruptcy can occur with any firm, but it is far more dangerous in the case of a jaebol.

In addition to these economic consequences, it is also widely held that most business groups have accumulated monopoly profits at the expense of consumers and smaller firms through the help of loans, both domestic and

foreign, and the protection of the Government. Moreover, the general public believes that the jaebol have invested their profits in unproductive sectors such as real estate and have influenced government policy to promote private interests. These negative general perceptions - notwithstanding the issue of whether or not they are justified - have fomented social tension. In conclusion, the concentration of economic power in the Republic of Korea has evolved into an issue with political and social dimensions transcending the simple economic sphere. As a result, the value judgements of individuals are often fused with the objective facts, rendering the whole issue all the more difficult to solve. As will be discussed below, the Government of the Republic of Korea has taken some important steps towards resolving this issue.

B. The evolution of fair trade policies

Although the general picture of industrial organization in the Republic of Korea has been coloured mostly by non-competitive elements, as shown above, related policy issues came to the surface only when the country was hit by the first oil shock in 1974. The severely distorted market mechanism and a sharp increase in the price of imported raw materials entrained inflation and demand-supply imbalances in a large number of markets. In order to tackle this problem, the Government laid heavy emphasis on microeconomic policy in addition to traditional macroeconomic policy mechanisms. In other words, the Government attempted to monitor selected individual product markets and apply pertinent policy measures as needs arose. The Act Concerning Price Stabilization and Fair Trade (hereafter, the "Price Stabilization Act") of 1975 was the legal foundation, for this new economic policy.

The Price Stabilization Act had two objectives, price control and assurance of fair trade practices. In actual implementation, however, price control and prohibition of a few categories of unfair trade practices were stressed. Extensive price regulation for about 150 monopolistic or oligopolistic products was carried out every year until 1979. In addition, a price ceiling system was placed, at the beginning on coal briquettes, and, between 1977 and 1978, on more than 20 items of daily necessity. The categories of items covered by the system were again reduced to only coal briquettes in 1979.

Turning to the restriction of unfair trade practices, 100 cases were investigated between 1976 and 1979. However, almost all of the 85 cases which actually came to be prosecuted were related to hoarding and cornering of markets of staple food products including rice in 1979. In contrast, not a single case of undue restriction of competition was prosecuted. Only one case came to be subject to this stipulation of the law. Paradoxically, the law was used to legalize collective activities in the cement industry four times under the rubric of recession or rationalization cartels.

The Price Stabilization Act had various unexpected side-effects, since it placed heavy emphasis on the regulation of prices, i.e., an element of market performance rather than structural aspects of the market. The direct price control of a wide range of commodities went beyond the limits of administrative capacity and invited a series of problems. Long-lasting price controls severely disturbed the price mechanism and gave rise to such phenomena as dual pricing and deterioration of product quality, as well as

chronic excess demand. Furthermore, most of the regulated firms lost interest in expanding production and consequently put little emphasis on capital investment, which weakened their ability to weather the business cycle. Since prices intermittently climbed sharply in a "stop and go" pattern, consumers could neither have reasonable expectations about prices nor plan their consumption rationally.

This experience, coupled with the aftermath of the second oil crisis, prompted a reappraisal of the past performance of the national economy and led to the general consensus that in the coming decades, the economy should be run by the unfettered functioning of the market mechanism. As the first major effort in this direction, the Fair Trade Act was enacted in April 1981, nullifying direct price regulation under the Price Stabilization Act and setting the comprehensive new "rules of the game" for the market economy - namely, free and fair competition. Therefore, this Act signified a fundamental change in government-business relations and was regarded as the economic constitution for a new era.

Two important issues arose when the Fair Trade Act was being drafted. First, the general principle of letting the market mechanism determine prices could not be upheld unless the market structure was competitive. Since the majority of product markets in the Republic of Korea were monopolistic or oligopolistic in structure, and price stabilization was regarded as the economic goal of the first order, this Act came to specify the prohibition of undue pricing activities by market-dominating firms and of parallel price increases by oligopolists. However, the clause on conscious parallelism was later deleted by the 1986 amendment, because it was believed to lack any theoretical justification.

The second issue was whether or not to use the Fair Trade Act as legal justification for a direct attack on the concentration of economic power. Despite many different opinions when a draft of the Act was under consideration, most believed that the jaebol issue should be addressed. This is averred in the first article of the Act, which identifies the prevention of the "excessive concentration of economic power" as one of the law's purposes. Nevertheless, the Act stopped at regulating business integration which would cause "substantial injury to competition". Furthermore, the Guidelines for Business Integration dealt only with horizontal and vertical integration, omitting conglomerate integration, the most powerful means for the expansion of business groups. Moreover, the concentration of corporate ownership, another facet of economic power, was left intact. However, these lacunae of the Fair Trade Act were filled to some extent by amendments in 1986 and 1990.

The provisions of the Fair Trade Act forbade the abuse of a market-dominating position. They restricted business integration, prohibited holding companies and cross investment between mother and daughter firms, limited the equity investment of big business groups, forbade collusive activities, prohibited unfair business practices and regulated international business contracts.

Before discussing the implementation of the Act against various types of anti-competitive activities and unfair practices, it should be pointed out, as one of its peculiarities, that this Act required other government authorities

to consult with the Minister of the Economic Planning Board, when they wished to introduce, amend or enact any laws, decrees, and administrative measures that might restrain competition. During the 1981 to 1989 period, there were 450 cases of consultations, of which 145 were rectified; more specifically, 99 out of 370 laws and decrees, and 46 out of 80 administrative measures.

First of all, the Fair Trade Act has prohibited the abuse of a market-dominating position. A market-dominating position refers to a firm meeting the following condition: either the share of the largest firm is greater than 50 per cent (monopoly) or the combined share of the top three firms is greater than 75 per cent (duopoly and oligopoly) in a market with total domestic sales amounting to more than approximately $US 45 million in the previous year. The FTC has designated "market-dominating firms" according to these criteria, annually.

Table 13 shows data for only two benchmark years, 1981 and 1990. One of the reasons for the sharp increase in the number of firms in this category is that the criterion of market size in terms of total domestic sales remains unaltered despite general price increases. Of 293 market-dominating firms designated in 1990, 25 were monopolist, 86 duopolist, and 182 oligopolist in 59 markets. In spite of the increasing number of market-dominating firms, only 10 firms were found to have abused their dominating positions: nine of them in hampering the business activities of other firms through false allegations and tying arrangements, and one in predatory pricing.

Table 13. Trends in market dominating firms

	1981		1990	
	markets	firms	markets	firms
Food & beverages	12	33	27	66
Textiles & fibre	1	2	1	3
Paper & paper products	2	6	5	14
Chemicals, petroleum & plastic products	5	12	34	71
Non-ferrous metals	2	4	3	5
Basic metals	9	15	17	34
Fabricated metals, machinery and equipment	11	30	38	97
Other manufacturing industries	-	-	1	2
Air transportation	-	-	1	1
TOTAL	42	102	127	293

The Act restricts integration by firms whose equity capital exceeds roughly $US 1.5 million or whose total assets exceed approximately $US 7 million if the firm may cause substantial injury to competition in any line of commerce. Given the anti-competitive effect, exceptions may be made for business

integration aimed at rationalization or strengthening the international competitiveness of an industry. This implies that, as clearly stated in its Article 1, the Fair Trade Act aims at the balanced development of the national economy rather than the unconditional pursuit of ideal competition.

A unique characteristic of this Act is that in addition to typical methods of business integration, such as stock or asset acquisition, mergers and interlocking directorate, it designates the establishment of new enterprises as a method of business integration. This is a response to the fact that, as mentioned earlier, more firms were newly established than the number which merged in the rapidly growing economy of the Republic of Korea. A meaningful and effective competition policy should take this finding into consideration.

Out of 1,846 cases of business integration reported up to 1989, the FTC issued 293 warnings for correction, two recommendations for correction, and seven orders to cease and desist. In terms of the type of business integration, 491 were considered horizontal, 349 vertical and 1,006 conglomerate. As earlier indicated, conglomerate integration has not been controlled and the Guidelines for Business Integration are currently being revised to include this feature.

Classifying by method of integration, 799 were through stock acquisition, 460 through the establishment of new firms, 276 through mergers, 186 through an interlocking directorate and 125 through asset acquisition. Most business combinations occurred in the manufacturing industry - 1,135 (61.5 per cent) in manufacturing, 181 (9.7 per cent) in transportation and warehousing, 164 (8.8 per cent) in construction, 134 (7.6 per cent) in wholesale and retailing, 31 (1.6 per cent) in restaurants and hotels, and 201 (10.8 per cent) in others (including financial services). Table 14 shows that among many different motives for business integration, diversification became more important, Whereas the improvement of the financial structure lost its predominance.

Table 14. Motives for business combinations

	1981	1989	1981-89
Diversification	14	50	464
	(9.5)	(25.9)	(25.1)
Improvement of the financial structure	84	23	484
	(56.8)	(11.9)	(26.2)
Rationalization of production processes	20	8	126
	(13.5)	(4.1)	(6.8)
Upgrading of the distribution system	9	9	75
	(6.1)	(4.7)	(4.0)
Liquidation of failing firms	7	3	85
	(4.7)	(1.6)	(4.6)
Disintegration	1	15	44
	(0.7)	(7.8)	(2.4)
Others	13	85	568
	(8.8)	(44.5)	(30.9)
TOTAL	148	193	1,846

Note: Figures in parentheses are percentage shares.

In addition to the restriction on business integration, the Fair Trade Act has provided for several specific measures to deconcentrate corporate ownership. Primarily, holding companies are prohibited and, thus far, three cases have been rectified. Direct cross-ownership between a parent and a daughter company belonging to a "large business group" is also prohibited. Although this type of intercompany linkage was not common in the Republic of Korea, 20 cases were remedied. Most Korean business groups have grown through intercompany shareholding, which can take either one or all of the radial, circular or matrix forms. Since it is extremely difficult to disentangle the complicated web of intercompany shareholding, the Act stipulates that any subsidiary of a large business group may neither obtain nor hold shares of other domestic firms, in excess of 40 per cent of its net assets.

In order to enforce the control on cross-ownership, the FTC has annually designated large business groups whose total assets exceeded $US 5.5 billion, which amounted to 43 groups in 1990. As mentioned earlier, the average intercompany shareholding ratio for the 30 largest business groups was 46.5 per cent in 1984 when no such restriction existed, but in 1989, this ratio for 43 groups as a whole had dropped to 31.5 per cent, far lower than the legally-set minimum level. In view of anticipated capital liberalization in the early 1990s, it will be an important issue to determine the optimal level of cross-ownership, especially in view of the possibility of takeovers by foreign firms. Additionally, subsidiaries of large business groups which engage in banking and insurance are also subject to this constraint; moreover, they may not exercise their voting rights in domestic firms in which they have invested.

The Fair Trade Act prohibits collective activities of firms, or cartels, which would substantially restrict competition in any line of commerce. The types of prohibited collective activities include cartels on prices, sales conditions, production and sales quotas, customers and market areas, production facilities and equipment, specialization, and joint ventures for collective management. However, the FTC can permit cartels deemed necessary for achieving industrial rationalization, overcoming cyclical recessions, facilitating industrial restructuring, enhancing the competitive strength of small- and medium-sized firms and rationalizing the terms of transactions. Up to 1989, 64 undue collective activities were remedied: 29 on prices, 14 on quotas, 10 on market areas, 6 on sales conditions, and 5 on specialization.

The Act also prohibits a number of unfair business practices, both of general and special categories. For the general category of unfair business practices, the FTC rectified 415 cases during the 1981-1989 period: 175 on false, exaggerated and misleading advertising, 121 on the abuses of advantageous position including coerced sales and forced offering of economic benefits, 18 on the refusal to deal, 35 on undue restriction of transactions such as exclusive dealing and territorial restriction, 66 on tie-in sales, price discrimination, boycott and other unfair practices. For special categories, the FTC corrected 194 cases on undue discount sales and 94 cases on the excessive offering of premiums on sales.

The FTC prohibits resale price maintenance as a special type of unfair business practice or a vertical restraint. This provision will be waived, however, for publications specified under the Copyright Act. Additionally, it

may not be applied to commodities which meet the following conditions: (a) their qualities can be recognized easily as identical; (b) they are for daily use by general consumers; and (c) free competition prevails in their markets. Up to 1989, 44 cases were corrected for resale price maintenance.

It was stated earlier that the Fair Trade Act had jurisdiction over international contracts between Korean firms and their foreign counterparts, insofar as concerned their undue collective activities and unfair business practices. Furthermore, the Act is applied not only to individual firms but also to trade associations. As mentioned before, trade associations have engaged rather extensively in various types of anti-competitive and unfair business practices. As of the end of 1989, there were 1,026 trade associations, a sharp increase over the 467 in 1970; of which 463 in manufacturing, 207 in wholesale, retailing, restaurants and hotels, 189 in social and personal services, 125 in transportation and warehousing, 27 in construction, 14 in financing, insurance, real estate and business services, and 1 in electricity and gas. Of these, 347 were organized by the Act for Small- and Medium-Sized Firms, and 331 by other special laws. In the 1981-1989 period, a total of 147 cases were recorded for the violation of the Act by trade associations: 64 on the restraint of competition, 36 on limiting the number of firms, 26 on unfair business practices and resale price maintenance, 21 on restricting the business activities of member firms.

Last but not least, as part of fair trade policy, the FTC administers the Act Concerning Fair Subcontracting Transactions of 1984 (hereafter the "Subcontracting Act"). Before this Act was enforced, subcontracting transactions were regulated, partially and separately, by individual laws for certain industries such as construction and electrical works. At the same time, the Act for Promoting Subsidiarization of Small- and Medium-Sized Firms of 1975 was not effective in preventing unfair practices in subcontracting. Moreover, while the original Fair Trade Act had also been applied to unfair subcontracting transactions it was inadequate for penalizing such violations through its provisions under the general category of unfair business practices.

The Subcontracting Act, incorporating and strengthening the related provisions in these laws, was enacted to guarantee fair transactions, especially between large order-placing firms and small- and medium-sized subcontractors. Between 1985 and 1989, the FTC had corrected a total of 560 subcontracting transactions: 238 in manufacturing and 302 in construction. For prompt enforcement of the Act, the FTC has also delegated some of its cases to the two committees for Reconciling Disputes in Subcontracting Transactions, for manufacturing and construction, respectively. During the 1985-1989 period, these committees successfully resolved 183 disputes and transferred 82 unresolved cases to the FTC.

Upon a closer look at the 1987-1989 period (chosen partly because of a lack of previous data), 488 cases (223 in manufacturing and 265 in construction) were corrected as unfair subcontracting transactions for the following reasons: 277 defaults of payment, 94 delays of payment, 58 refusals to issue required documents, 10 undue reductions in payment, 7 defaults of advance payment, and 42 other unfair practices. The sheer number of cases rectified may belie the fact that, in general, disadvantaged subcontractors are not willing to venture the risk of retaliation by bringing charges of

unfair practices against large firms. Since fair trade cannot be maintained through the mere enactment of a law, greater efforts should be exerted to foster an environment in which all firms, particularly large ones, voluntarily observe the spirit of the Subcontracting Act.

IV. CONCLUDING REMARKS

In this paper some important aspects of corporate policies in the Republic of Korea have been reviewed with special reference to restrictive business practices. The evolutionary path of such policies may be described concisely as making steady progress toward overall economic liberalization commensurate with a free market economy. In retrospect, it may be considered as an outcome of natural historical dynamism as well as one of deliberate choices made in response to changing conditions. In this resource-poor country, the government-led rapid economic growth inevitably resulted in extensive government intervention, and highly concentrated market structure and corporate ownership. The political regimes which had engineered such policy and had received partial justification through the economy's performance were characterized by authoritarianism.

As mentioned earlier in the Introduction, this politico-economic system had reached its limits towards the end of the 1970s. The Government of the Republic of Korea realized that it should bring the country into a new economic system respecting the working of the free-market mechanism and the freedom of the people to make their own decisions. In the area of corporate policies, the Government energetically promoted liberalization or competition both on the domestic and foreign fronts. This reorientation of economic policy, as part of a move toward "economic democratization", accelerated since political democratization started to gain momentum in 1988. The corporate policies reviewed here are conspicuous examples of such a change. This fact points to the "truth" that politics and the economy are two sides of the same coin. In other words, a competitive economic order cannot be separated from a democratic political system, since both are based on the same philosophy and logic.

One may regard monopoly and competition as alternative types of market structure, especially in a small developing economy. The structure of a market is determined, among other factors, by its size and the state of technology available. One cannot make the choice between monopoly and competition a policy variable. Moreover, monopoly cannot be sustained long, unless dictated by laws or administrative orders. The Korean experience clearly demonstrates that competition supersedes monopoly as an inevitable consequence of economic development.

It is sometimes argued that monopoly is necessary to obtain efficiency, whereas competition tends to be wasteful in the early stage of economic development. Although the logic of this argument may not be entirely denied, it should be noted that eventually "artificial" monopoly not only hampers economic efficiency itself but, more importantly, discourages the competitive spirit of society that is the real engine of economic growth. Monopolization by government intervention may give rise to that community of interest and concommitant "government failures" which cannot be eliminated easily in a society marked by traditional communitarianism and bureaucratic

authoritarianism. Competition policy or fair trade policy, should, therefore, be assigned a foremost position on the agenda for long-run, self-sustaining economic growth. Unless the general public is market-minded, market-oriented economic policy cannot succeed.

Before concluding this paper, it would seem appropriate to discuss briefly several tasks for the country's future competition policy, putting aside minor and technical issues. They may be important tasks not only for the Republic of Korea but also for other countries wishing to enforce an effective competition policy.

Firstly, in light of its multifaceted, complex nature, the issue of the concentration of economic power must be tackled through steady implementation of a comprehensive policy, including not only strict enforcement of the Fair Trade Act but also reformulation of other measures related to business licensing, tax, financing, and trade. In addition to these measures to eliminate the major concentratons of economic power, more competitive pressures should be imposed on business groups by removing the barriers to entry by domestic and foreign firms, while the countervailing power of small- and medium-sized firms, labour unions and consumers will need to be augmented. These measures can force business groups to disengage from anti-competitive or ineffecient market conduct.

Secondly, regulation or deregulation must be continuously reviewed in response to ever-changing technologies. What, when and how to deregulate should be discussed in an open forum to eliminate the undue influence of private interests of the parties involved, whether public or private. Deregulation should, in principle, be simultaneously enforced across all industries concerned. Otherwise, resource reallocation will be concentrated in a few deregulated industries. Attempts should be made to minimize adjustment costs to producers and consumers who will be adversely and directly affected by deregulation. Deregulation must also be enforced in close step with import liberalization, since both measures serve to open a market for competition. Such deregulation will be more important in view of the Uruguay Round. Deregulation does not imply simple laissez-faire, however. On the contrary, fair trade policy must be strengthened to guard against the abusive conduct of market-dominating firms.

Thirdly, competition policy, while based on the Fair Trade Act, must also be coordinated with other policies. In so far as this policy provides the most fundamental framework for market order and also contains elements of general industrial policy, other industrial laws such as the Industrial Development Act, the Copyright Act and the Patent Act must be recast and enforced within the boundaries set by this Act. Currently, activities "justifiable" by such laws are exempted from the Fair Trade Act. In a similar vein, external trade policy must be harmonized with internal competition policy. An attempt to distinguish between the two policies will be futile in the open economy. Similarly, on the international front, competition policies of different countries must be coordinated in order to apply, as far as possible, uniform rules and exchange information on the market conduct of firms across countries. Such cooperation becomes more important as more firms, multinationals in particular, expand their business activities on a global scale.